

CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes

November 15, 2005

The Capital Projects and Bond Oversight Committee met on Tuesday, November 15, 2005, at 1:00 PM, in Room 113 of the Capitol Annex. Senator Elizabeth Tori, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Elizabeth Tori, Co-Chair; Representative Mike Denham, Co-Chair; Senator Jerry Rhoads; and Representatives Robert Damron, Paul Marcotte, and Jim Wayne.

Guests testifying before the Committee: Dr. Deborah Clayton, Warren Nash, and Katie Smith, Cabinet for Economic Development; Bob Wiseman, Dr. Michael Karpf, Frank Butler, and Sergio Melgar, University of Kentucky; John Hicks, Governor's Office for Policy and Management; Steven Biven, Finance and Administration Cabinet; Sandy Williams, Kentucky Infrastructure Authority; and Tom Howard, Office of Financial Management.

LRC Staff: Mary Lynn Collins, Pat Ingram, Nancy Osborne, Kristi Culpepper, Bart Hardin, and Shawn Bowen.

Representative Marcotte made a motion to approve the minutes of the October 18, 2005 meeting. The motion was seconded by Representative Denham and approved by unanimous voice vote.

Senator Tori called on Ms. Mary Lynn Collins, Committee Staff Administrator, to review correspondence items. Ms. Collins said members' folders included five items of correspondence: follow-up correspondence from Tom Howard, Executive Director, Office for Financial Management, regarding the interest rate swap associated with Kentucky Asset Liability Commission General Fund Tax and Revenue Anticipation Notes, 2005 Series A; a report submitted by the University of Louisville regarding the purchase of unbudgeted scientific research equipment; the Kentucky Lottery Corporation's monthly financial report for September 2005; a quarterly status report from the Administrative Office of the Courts on court facility construction and renovation projects; and quarterly status reports on authorized capital projects from the Finance and Administration Cabinet, Murray State University, University of Kentucky, University of Louisville, and Western Kentucky University. Ms. Collins briefly explained that the process used for submitting quarterly status reports has changed from manual to

electronic submittal. The Finance and Administration Cabinet and the universities can now go to the Committee's website and enter in the status information for the reports. She recognized Ms. Pat Ingram, Committee Staff Administrator, Capital Planning Advisory Board, and the LRC Information Technology staff, for their hard work in developing the quarterly report format.

Senator Tori asked Dr. Deborah Clayton, Commissioner of the Department for Commercialization and Innovation, Cabinet for Economic Development, to brief the Committee on the Innovation and Commercialization Center initiative, including the program's accomplishments, the level of the state's financial investment, and the return on its investment.

Dr. Clayton briefed the Committee on the history of the Innovation and Commercialization program. The program was authorized by KRS 154.12-305 for the purposes of creating products, new companies, and value-added jobs in communities throughout the Commonwealth. The statute establishes six regional affiliates, known as Innovation and Commercialization Centers (ICCs), and the primary focus of each ICC is to fulfill the duties set forth in KRS 154.12-305 relating to the implementation of the region's strategic plan and supporting the Kentucky Innovation Act initiatives in the region or sub-region.

Dr. Clayton said the six regional ICCs are located in Louisville, Lexington, Covington, Richmond, Bowling Green, and Murray. KRS 154.12-310 also authorizes the establishment of a number of satellite offices, known as Innovation Centers (ICs). There are seven ICs: Williamstown/Grant County; Ashland; Pikeville; West Liberty; Elizabethtown; Paducah; and Paintsville. Each of the ICCs and ICs have a postsecondary affiliate, and public and private partners that provide cash and in-kind support to help with operating costs. The state provides up to \$150,000 annually for operating expenses for each ICC. Funding for the ICC and IC programs, and the management fee, comes from the state funded New Economy Pools.

Dr. Clayton said since 2001, the Department for Commercialization and Innovation (DCI) has contracted with the Kentucky Science and Technology Corporation (KSTC) to manage and administer the six ICCs and to some extent the ICs. She said DCI has received requests for funding for an additional 10 regional ICs to be located in Madisonville, Hopkinsville, Henderson, Glasgow, Owensboro, Springfield, Monticello, Somerset, Corbin, and Maysville. The Eastern Innovation Region has also suggested, but not formally requested, DCI to fund ICs in Richmond, Danville, Hazard, and Middlesboro.

Dr. Clayton said some of the recently implemented changes to the program include: ICCs performance metrics now emphasize creation of new high-tech jobs/companies; ICCs are now affiliated with an academic institution; ICs are now

affiliated with an ICC with the same performance metrics; ICCs/ICs are encouraged to be affiliated with local Small Business Development Centers (SBDCs); and ICCs/ICs are encouraged to be self-sustaining by July 2007. Dr. Clayton noted that it will be easier for ICCs located in Louisville and Lexington to become self-sustaining by the July 2007 deadline, than it will be for ICCs located in the Eastern and Western Region. She said she wanted to make sure that the existing ICs are functioning at a level agreeable to all before any additional ICs are created.

Dr. Clayton said since the ICC's creation in 2001, there have been approximately 850 high tech jobs created that pay an average salary of \$57,000 or above; approximately 100 new companies have been created with \$37 million in new revenue generated; there are 796 active clients; and \$3 million in total annual income taxes has been paid.

In conclusion, Dr. Clayton said the performance of the ICC is better than originally perceived, but there needs to be more focus given on the performance standards considering investment versus return, and there needs to be more guidance directed at ICCs/ICs.

In response to a question from Senator Tori, Dr. Clayton said she and her staff have assumed a more active role in administering the program than in the past, but KSTC is responsible for oversight of the ICCs.

In response to a question from Representative Denham, Dr. Clayton said the DCI's website is currently under construction, and once it is active, it will contain a list of all the ICC/IC client profiles, as well as links to the ICCs, ICs, and KSTC.

Representative Marcotte asked what the state's total investment is in the program. Dr. Clayton said the total program request was \$32 million, and there was \$26 million in the fund. She said the \$26 million is not all new money, but includes carryover from prior years.

In response to another question from Representative Marcotte, Dr. Clayton said they have received requests for 14 additional ICs. She said each IC is given \$75,000 annually for operating expenses, so at that level of support, it would take an investment of approximately \$1,050,000, to start 14 more ICs.

Representative Marcotte asked about the program in Northern Kentucky known as Tri-Ed. He asked what Tri-Ed, Northern Kentucky University, and the state has invested in the program, and what businesses have been developed as a result of the program. Dr. Clayton said she did not have that information with her, but she would find out and forward it to the Committee.

Dr. Clayton said her office is in discussion with Tri-Ed right now regarding a proposal. Representative Marcotte said if the program is getting results and developing new business, he supported it. However, he said it concerned him when the state is picking the winners and losers. Dr. Clayton said when proposals come in, they sit down with the applicants and try to determine how the proposal is going to create jobs and companies. She said she envisions that in the future, the proposals will be reviewed by outside reviewers.

Representative Wayne referred to the KSTC annual report distributed to members by Dr. Clayton, and said it appears that the state is paying KSTC \$.50 for management of every \$1 spent on the program. Dr. Clayton responded that was correct.

Representative Wayne said if the state is investing in start-up companies, it should be looking for venture capitalists to come to Kentucky and invest. He asked who is responsible for monitoring the venture capital program. Dr. Clayton responded that KSTC is responsible for monitoring the program. DCI provides a management fee to KSTC for oversight of the ICCs and the ICs, but other than that, DCI does not have any direct involvement with KSTC's investments.

Representative Wayne asked what happens if the ICCs and the ICs are not self-sustaining by the June 2007 deadline. Dr. Clayton said they will determine on an individual basis which to fund after 2007. She said the entities will not automatically be cut off after the deadline, but they would like to see a gradual progression towards that goal.

Senator Tori thanked Dr. Clayton for her presentation to the Committee. She said this report was made at the Committee's request, and no further action was required.

Senator Tori said the Department of Commercialization and Innovation had also submitted a report of ten grants made from the High Tech Investment/Construction Pool that did not require Committee action.

Next, Mr. Bob Wiseman, Associate Vice President for Facilities, University of Kentucky (UK), and Dr. Michael Karpf, Executive Vice President for Health Affairs, discussed the UK Hospital Bed Tower project. Mr. Wiseman said he was appearing before the Committee to provide an update on the project, and to request approval of the consolidation of separate authorities into one project.

Mr. Wiseman said the legislative authority for this project is contained within several state budgets. The initial master planning and design authority, \$10 million, was in the 2002-2004 state budget. In the 2004-2006 state budget, the legislature partially authorized the project with approval for \$100 million in agency bonds, and \$100 million in restricted funds. Mr. Wiseman said UK is asking the Committee's approval to formally

consolidate with the Hospital Bed Tower project three restricted fund infrastructure projects that also were in the 2004-2006 budget. Those projects are as follows: Expand Plant Capacity Infrastructure project, \$23,000,000; Replace Cooling Plant Chillers project, \$6,000,000; and Central Heating Plant Improvement project, \$4,000,000. The University also plans to allocate \$5 million from its Land Acquisition Pool to acquire land for this project. Including the \$5 million allocation for land acquisition, if the projects are consolidated, the current authorization of the Bed Tower project would be \$248,000,000.

Mr. Wiseman noted that HB 497, 2005 Regular Session, recognized that the University would seek additional bonding authority for another \$150 million in the 2006-2008 budget. The bonds are to be fully repaid by hospital revenues. He said the University would also seek authorization to increase the project by approximately \$52 million in restricted funds. The project, as now planned, is at a \$450 million scope. Mr. Wiseman said this plan of financing at the \$450 million scope and the proposal to consolidate these authorities was fully reviewed and approved by the UK Hospital Board of Trustees on October 24 and by the full University Board of Trustees on October 25.

Dr. Karpf said the Hospital went through a substantial amount of strategic and financial planning over the last several years. He said they also undertook an analysis of the Hospital's physical plant to make sure it could support the ambitions they have to become a top 20 institution.

Dr. Karpf said the first step in doing the physical plant analysis was a current facility assessment that involved deciding which buildings they could use in the future and which buildings would have to be replaced.

Dr. Karpf said the new facility will be located at the site of the current hospital parking garage and will ultimately replace the old hospital. Phase I of this project will involve replacement of the hospital garage; construction of a five level (counting basement) hospital base topped off with two bed towers of six stories each at the site of the current parking garage; and construction of an integrating lobby to connect the buildings.

Dr. Karpf said as they have been planning this process, they have also been building their clinical programs. Over the last four fiscal years, the University has had a substantial amount of growth due to the faculty being energized, and due to recruitment of outstanding clinicians from around the country. He said clinical growth is one of the major factors that will ensure UK's ability to continue to finance the building project. He said they are two years ahead of schedule in terms of clinical growth, and have met and exceeded their models for growth. He said as the University has grown clinically, the school's research profile has also grown.

Dr. Karpf said he realized UK has to be accountable to the legislature as it goes through the project, and they are fully committed to reporting back to the Committee periodically on the project. However, on a project of this scope, he said they need some flexibility in terms of bonding and investment strategies that will allow the project to move along in a timely fashion.

Representative Wayne asked what the hospital's net income was. Dr. Karpf said the hospital's net income at the end of the first quarter of this year was approximately \$19 million.

Representative Wayne asked if all of the funds authorized under the consolidation will be used to address chiller and utility plant infrastructure. Mr. Wiseman responded that they would. He said in the original Bed Tower Hospital project, approximately \$25 million was identified for infrastructure needs. After engineering and planning, they have concluded that they will need approximately \$50 million, and that is the reason they wish to consolidate the other "generic" unspecified projects intended to expand plant capacity for new construction.

Representative Wayne thanked Mr. Wiseman and Dr. Karpf for their leadership and vision.

Senator Tori noted that much of the space in one of the two bed towers will be shelled space. She asked what is the anticipated cost of the future fit-up of this space. Dr. Karpf said it may cost as much as \$150 million to fill out the shelled space. He said the project is set up in two phases so they will be able to use the new building immediately. By keeping this project contiguous with the old hospital, they can expand or decrease this project, depending on the finances. Mr. Wiseman added that the space is being shelled because it is easier to build a shelled space on top of the hospital now than to later try to put a tower on top of an existing operating hospital.

Dr. Karpf said if they build a second bed tower now, the University can save as much as \$12 million by constructing the shelled space while the cranes are in place. Also, the shelled space allows them to complete the next phase in pieces. Construction on the second bed tower will not start until 2008 so they have built redundancy into the building to scale up or scale down as needed.

Senator Tori said this is a good example of forward thinking and thanked Dr. Karpf for his explanation.

Representative Denham made a motion to approve the University's request to consolidate the projects. The motion was seconded by Representative Damron and approved by unanimous roll call vote.

Senator Tori asked about the status of the Memorial Coliseum Basketball Practice Facility project. Mr. Wiseman said this facility is under construction now, approximately \$27.5 million will be used for construction, and \$2.5 million for design of the project. Mr. Wiseman said the Athletic Department is actively fundraising for this project, and the Board of Trustees at its last meeting, approved the issuance of \$7 million in bonds approved in the 2004-2006 budget. Frank Butler, Executive Vice President for Finance and Administration, UK, said the Athletic Department has \$20 million in written pledges and \$3 million in verbal commitments, and they are still working on a naming gift. He said when bond financing of \$7 million is combined with cash and pledges, the project scope is covered. Mr. Butler said the bond financing will assist with the cashflow of the project, and they have the money available to them in the quasi-endowment within the Athletic Department to cover the project.

Senator Tori asked Mr. John Hicks, Deputy State Budget Director, Governor's Office for Policy and Management, to present the Finance Cabinet's monthly report to the Committee. Mr. Hicks reported an appropriation increase of \$125,000 to a project administered by the Kentucky Community and Technical College System (KCTCS). The Southeast Community College Belinda Mason Academic/Technical Building and Walk Bridge project has been appropriated \$125,000 to address additional costs for the pedestrian bridge. Mr. Hicks said the funding source for the increase is the Letcher County Fiscal Court (coal severance tax funds), and was identified in the 2004-06 Budget Memorandum. The revised project scope is \$5,415,000. No further action was required on this project.

Mr. Hicks next reported two federally funded unbudgeted projects. He reported that the Council on Postsecondary Education (CPE) Kentucky Adult Education plans to purchase a 38-foot mobile education lab with a \$300,000 grant from the U.S. Department of Education. He said this lab is outfitted with approximately 12 work stations, and will be used to do on-site workplace essential skills training at business locations. This would be the third lab the adult education and literacy program will operate.

Next, Mr. Hicks reported the Kentucky Higher Education Student Loan Corporation (KHESLC) plans to establish an unbudgeted project to purchase two highlight color print systems at a cost of \$212,000 each. The total cost of the purchase, \$424,000, will be financed with federal funds.

Representative Damron made a motion to approve the two unbudgeted federally funded projects submitted by the Finance and Administration Cabinet. The motion was seconded by Representative Marcotte and passed by unanimous roll call vote.

Lastly, Mr. Hicks reported a transfer of \$400,000 from the Department of Agriculture's FY 2005-06 operating budget for the PACE program to the capital budget for the purpose of expenditure. Senator Tori said no action was required on this project.

Mr. Steve Biven, Director, Division of Real Properties, presented four lease reports. Mr. Biven first reported a new lease for the Department of Workers Claims in Fayette County. He reported that Workers Claims will sublease 10,717 SF from the Council of State Governments at an annual cost of \$141,465. Mr. Biven noted that the Department of Workers Claims is moving from a privately held lease to property that is owned by the Commonwealth.

Representative Damron made a motion to approve the new lease. The motion was seconded by Representative Wayne and passed by unanimous roll call vote.

Mr. Biven then presented two emergency leases for the same agency, the Alcoholic Beverage Control (ABC) Office. He explained that ABC is being required to temporarily vacate its leased space at 1003 Twilight Trail in Franklin County due to a roof collapse. ABC staff are being split into two separate facilities, PR-3920, an emergency lease modification for space currently leased by the Department of Education at 209 St. Clair Street in Franklin County, is being modified to include 6,500 SF to accommodate ABC staff; and PR-4762, a lease of 4,839 SF at 373 C Versailles Road in Franklin County, is being established to accommodate the remaining ABC staff. Senator Tori said since these leases were procured under emergency conditions, no Committee action was required.

The final item Mr. Biven reported was four state leases with square footage modifications from July through September 2005. Since each of the modifications were less than \$50,000, no action was required.

Senator Tori next welcomed Ms. Katie Smith as the new Deputy Commissioner for the Department for Financial Incentives, Cabinet for Economic Development. She then asked Ms. Smith to report on a proposed Economic Development Bond (EDB) grant.

Ms. Smith reported a proposed grant of \$100,000 to the Caldwell County Fiscal Court to benefit Hydro-Gear, Inc. The grant will be used to contribute to the company's acquisition of a 67,500 SF facility in the Princeton Industrial Park.

Ms. Smith said the EDB grant agreement stipulates that Hydro-Gear, Inc. will create 150 new full-time jobs for Kentucky residents within two years of occupancy of the facility, and the company will be required to pay the new employees an average wage of no less than \$11 per hour. Hydro-Gear will also be required to maintain these jobs for an additional three years. If the company fails to meet these requirements, it must pay the Caldwell County Fiscal Court \$667 per job not created or maintained. Ms. Smith said the company has also received preliminary approval of \$3 million in tax credits under the Kentucky Industrial Development Act.

Representative Wayne asked if employees will have the same benefits package as employees at Hydro-Gear, Inc. headquartered in Sullivan, Illinois. Ms. Smith said she did not know, but she would find out and relay the information to the Committee.

Senator Rhoads made a motion to approve the EDB grant. The motion was seconded by Representative Marcotte and approved by unanimous roll call vote.

Ms. Sandy Williams, Kentucky Infrastructure Authority (KIA), next reported three new KIA Fund A (Federally Assisted Wastewater Revolving Loan fund) loan requests. Ms. Williams reported that the City of Loretto, Marion County, is requesting an increase of 10% (\$208,715) to an existing Fund A loan. The loan increase is needed to return previously bid alternates to the project. The revised loan amount would be \$2,295,863.

Ms. Williams next reported that the City of Morehead-Morehead Utility Plant Board, Rowan County, is requesting an increase of 9.6% (\$630,919) to the existing Fund A loan. The new funds will be used for increased design and construction costs relating to the addition of the North Fork Triplett Creek interceptor sewer. The revised loan amount would be \$7,189,123.

The third KIA Fund A loan Ms. Williams reported was a loan to the City of Paintsville in Johnson County. The proceeds, \$429,715, will be used to make improvements to the wastewater treatment plant and collection system.

Representative Wayne made a motion to approve the three KIA Fund A loans. The motion was seconded by Representative Damron and passed by unanimous roll call vote.

Ms. Williams said also included in members' folders was a report from KIA regarding 33 line-item Coal/Tobacco Development Grants approved in the 2004-06 budget. She noted that the Tobacco Development Grant for the Morehead Utility Plant Board was submitted prematurely, and has been pulled from the agenda. She said this grant will be submitted at a future date. No further action was required on these projects.

The next report was provided by Mr. Tom Howard, Executive Director, Office of Financial Management (OFM). Mr. Howard presented four new bond issue reports. First reported was Kentucky Economic Development Finance Authority (KEDFA) Hospital Facilities Adjustable Rate Hospital Facilities Revenue Bonds, Series 2005, (The Harrison Memorial Hospital, Inc. project). Mr. Howard said the proceeds from this issue, \$16,000,000, will be used for a hospital expansion project in Cynthiana, Kentucky.

Mr. Howard next reported KEDFA Multifamily Housing Revenue Bonds, Series 2005 (GNMA Collateralized-Christian Care Communities projects). The proceeds from this issue, \$13,465,000, will be used to refund and retire debt associated with Christian

Care Communities, Inc. and to finance the renovation of facilities originally constructed with the debt to be refunded.

The third new bond issue Mr. Howard reported was Murray State University Housing and Dining System Revenue Bonds, Series Q, dated December 1, 2005. Gross proceeds of \$15,739,271 will provide for the construction of a new Student Residential College Facility and will pay costs associated with the bond issue.

The last new bond issue Mr. Howard presented was University of Kentucky General Receipts Bonds, 2005 Series A, dated December 1, 2005 (Memorial Coliseum Expansion project - Basketball Practice Facility). Proceeds from this bond issue, \$7,184,742, will provide partial funding for the renovation and expansion of Memorial Coliseum.

Representative Wayne made a motion to approve the four new bond issues. The motion was seconded by Senator Rhoads and passed by unanimous roll call vote.

Mr. Howard presented one follow-up report for a previously approved bond issue: Kentucky Housing Corporation Housing (KHC) Revenue Bonds, 2005 Series F, G, and H, \$79,315,000.

Representative Wayne noted that KHC entered into a swap agreement to convert the variable rate bonds to a synthetic fixed note, and asked about the swap costs. Mr. Howard said traditional housing bonds have a variety of embedded call features that are associated with those that raise the interest rate on traditional fixed rate bonds. He said as the mortgage yields have compressed tax-exempt versus taxable, they have had to look at alternative structures to drive the cost of those down. One of the ways to do that is to jettison some of the options that are embedded in the fixed rate bonds, and in exchange for that you get economic value. He said in this case the economic value is projected to be approximately \$3 million on a present value basis for the KHC by swapping a portion of the bonds back to a fixed rate. Senator Tori said this follow-up report was for a previously approved bond issue, and no further action was required.

Mr. Howard next presented two new school bond issues with School Facilities Construction Commission (SFCC) debt service participation for Elliott County and Garrard County.

Representative Wayne made a motion to approve the two school bond issues. The motion was seconded by Senator Rhoads and passed by unanimous roll call vote.

Ms. Collins said there were two locally-funded school bond issues submitted to the Committee for review this month: Hazard Independent (Perry Co.) and Monroe

County. She said all disclosure information has been filed, and no further action on the bond issues was required.

Senator Tori said the debt issuance calendar was also included in members' folders. No action was required for this report.

With there being no further business, the meeting adjourned at 3:00 p.m.